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Determinants of Profitability and Growth of Some Selected Small and Medium Scale Enterprises in Nigeria

By

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ABSTRACT

The primary goal of this study is to identify the key financial factors that influence the management of small and medium scale businesses in Delta State's especially in Ndokwa Nation in terms of growth and profit. The growing significance of small- and medium-sized business strengthening as a barometer of success and sustainability to prevent perpetual business failures and to get finance possibilities made the study necessary. In order to achieve this goal, a number of financial factors that have been discussed in a variety of literatures were examined to determine how well they might predict the rate of entrepreneurial development and profit. The study area comprised three Local Government Areas in Delta North Senatorial District (Ndokwa Nation) where 35 small-medium scale businesses were purposively selected. Secondary data used for the study were sourced from Chambers of Commerce and Industry, Asaba and at the Delta State Office of Corporate Affairs Commission, Asaba, Delta State. Ordinary Least Square (OLS) method was used in estimating the regression equation while t-test was employed in testing the four hypothesis of the study. Findings revealed that capital base, pricing policy, business volume and managerial efficiency were major determinant of profitability and of SME's entrepreneurial growth. The study recommends therefore that enterprises should increase their capital base and compete at the current market price if they tend to be efficient and productive. Also, emphasis should be placed on managerial efficiency of both the board and the hired management (intrapreneurs) so as to grow their business and avoid small-medium businesses going moribund.

Keywords: Profitability, Small and Medium Enterprises, SME's financing, Rural and Semi-Urban Areas, Delta State, Nigeria.

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1.0 INTRODUCTION

For a company to stay in operation and survive competition from other businesses in the same sector, profit maximization is a vital goal. It is a crucial prerequisite for a company's long-term existence and development and a prerequisite for achieving other financial objectives of a corporate entity (Gitman and Zutter, 2012). A key component of a company's financial reporting, profitability is a key indicator of its performance. It displays the company's potential to make money at a given rate of sales, asset level, and capital stock over a given time frame (Margaretha and Supartika, 2016). As a result, the profitability of businesses and strategies for increasing it have sparked heated discussions in the literature and are still relevant in the fields of management, accounting, finance, and economics. Profitable businesses provide value, employ people, are often more inventive and socially conscious, and they pay taxes that support the economy as a whole. High business performance rates do in fact effectively contribute to the creation of income and the general growth of an economy (Olutunla and Obamuyi, 2008; Lazar, 2016). Thus, utilizing cutting-edge and complex theoretical models, researchers have worked diligently to identify the variables influencing profitability at the business and industry levels (Pratheepan (2014) and Al-Jafari and Al-Samman (2015). It makes sense to look at the factors that influence a company's profitability in Nigeria for a variety of reasons. During the last ten years, Nigeria's economy has seen a number of improvements under many democratic administrations. Nonetheless, there hasn't been much study done to identify the primary factors influencing the profitability of a variety of businesses as a result of these legislative changes. Nigeria, South Africa, and Egypt have relatively substantial stock markets, yet company performance has remained appallingly low. Many Nigerian businesses have underperformed compared to expectations when it comes to profitability, total output, revenue creation, and innovation.

The rate at which business enterprises go moribund, two, three, four to five years after registration with the Corporate Affairs Commission is alarming. Inspite the fact that the small scale businesses are run based on predetermined norms called entrepreneurial objectives or "entrepreneurial values and principles". However, if they depart from this so-called value system, there is no entrepreneurial continuation hereafter. In the recent times, the debate for business failures has dominated many discussions in economic and business literatures. It was argued that our rural small business managers find it difficult to separate their businesses from domestic responsibilities and parochial reasons hence their establishments' short-lived.

The National Bureau of Economic Research says that the rate of application for new business is higher than ever. While it seems like good news, the failure rate of small business remains high, 20% fail after 2 years, 50% after 5 years and 70% go moribund after 10 years (Eshiobo S.S., 2010). Though according to Lake Ananth, 2012 "Failure is not an Entrepreneur's enemy" even though it causes set back in business.

According to Hamid Rab Nawaz, 2022, reasons why Entrepreneurs fail it's not just about the business plan. Entrepreneurs who fail to plan are often guilty of several other planning related deficiencies: Not setting goals or having a clear vision for their companies, Being afraid of change even when its necessary or beneficial, Not taking into account all the factors that could affect their business, including market conditions and competition, when making decisions about product and services. The solution is simple, every entrepreneur needs to start with planning, Eshiobo S.S. (2010). But how much is enough? Is there such a thing as too much planning? The answer will vary from person to person, but one thing remains true, no matter how much you think you know about your industry, your product or service, and the market in general, there is something else you didn't think of (or haven't considered yet).

Innovation is important, but it's difficult to get it right, (Garba, 2010). In order to be innovative, you need to think outside the box. If you want your business ideas to stand out from its competition offerings, then they have to come up with original concepts, ideas that haven't been tried before. When you're starting a business, location can be a major factor in your success or failure, (Neck and Marray, 2017). It is important to consider the environment around your business, like any other factor that comes into play.

Location can be expensive and difficult to find; if you don't have access to a good space for it, then it will be hard for customers, to find you. Location also affects customer base and competition. If there are already many other businesses in the area similar to yours, then they might already have all those customers' loyalty and attention.

The first and foremost reason why entrepreneurs fail is due to a lack of customer focus, which results in ignoring customers' needs and wants. If you ignore your customers, you are at lost. So do you keep track of who target audience is?

One good way is through surveys and questionnaires use them as an opportunity for feedback by asking specific questions about their experience with your brand or product. You can employ social media tools like Facebook or Twitter as a means for direct engagement with potential customers. We have other reasons such as not being fully committed, mismanaging financies, appreciate your weaknesses and shortcomings and make amends.

The term entrepreneur is a French word and is derived from the French word "entreprendre". It means to undertake, to pursue opportunities, to fulfill needs and wants through innovation. The word first appeared in French dictionary in 1723. It is commonly used to describe an individual who organizes and operates a business or businesses, taking on financial risk to do so. It is believed that the Irish Banker operating in France, Ricardo Cantillion was the first person who used the word "Entreprendre" in Economics as an agent who assembles materials/inputs for producing goods and services (Kent, 1994). Also the Frenchman J.B. Say (1827) first used the term "Entreprendre" as an Economic agent who brought together the factors of production in such a way that new wealth could be created. Oxford Dictionary adopted the word "entreprendre" as entrepreneur in 1897, and it meant Director or Manager of business

organization. Webster's Third New International Dictionary (1961) takes it as, an organizer of an economic venture, especially one who organizes, manages, and assumes the risk of a business.
It was Schumpeter however, especially one who really launched the field of entrepreneurship by associating it clearly with innovation.

The importance of measuring organizational performance cannot be overemphasized whether in entrepreneurship or other forms of businesses. According to Onwchekwa (2000) periodic evaluation of organizational objectives are achieved. Not only that, it is critical especially in managing business venture and as well monitor the growth and pitfalls therefrom. This will enable the business managers take corrective actions.
There are both qualitative and quantitative techniques for measuring business performance. These include good human relations, community service and market design amongst others. Qualitative techniques include the value of profit, volume of transaction, population covered and percentage of returns.
In recent times, the amount of profit generated in business has become a cardinal technique for assessing performance. Akubuilo, 1987 hold the same view. Admittedly, the increasing wave of globalization, increasing rate of debt financing, highly competitive market and need for survival by small/medium scale enterprises have propelled business managers to start paying adequate attention so as to nip business failures in the bud.
This study therefore seeks to identify those variables or factors that can significantly reduce business going moribund and promote profit-value.

2.0 LITERATURE REVIEW

2.1 Concept of Profitability

A company's profitability is determined by its capacity to turn a profit, which is the amount of money left over after all costs are covered. It is an essential indicator of a company's financial stability and development potential, making it a critical business statistic. Profitability is a key performance indicator for companies since it shows their stability and capacity for expansion. Businesses may increase their profitability and make more informed decisions by being aware of the important words associated with profitability.

Conversations concerning the success of businesses that are often assessed by their profitability have centered on several hypotheses. Among these ideas, the scale-efficient firm hypothesis (SEFF), the X-efficiency hypothesis (XEFF), the quiet-life hypothesis, the efficient structure hypothesis (ESH), and the structure-conduct performance (SCP) paradigm are leading theoretical frameworks. Two of the most influential theories of industrial organization in industrial economics are the efficient structure hypothesis (ESH) and the structure-conduct performance (SCP) paradigm. These theories provide both structural and non-structural methods for analyzing the relationship between market structure and firm performance (Seelanatha, 2011). According to the SCP paradigm, market concentration encourages major companies in an industry to collude, which helps the industry's profitability. This means that market concentration generally affects a firm's performance in a positive and direct way (Goldberg and Rai, 1996; Worthington, Briton and Rees, 2001). The neoclassical theory is the source of the SCP model.From the SCP paradigm, the relative market performance hypothesis (RMPH) was developed. It makes the argument that only companies with a sizable market share and distinctive products may acquire the market strength needed to raise profits by using non-competitive pricing techniques (Berger, 1995).

Enterprise is a product of entrepreneurship. It is a project or undertaking venture, organization, industry, corporation, establishment, shop, bureau, agency, franchise, consortium, cooperative, group, conglomerate etc. Enterprise or Entrepreneurship has no universal definition. Various scholars have defined it in their own ways. However entrepreneur is enterprising, it can also be referred to starting a business or undertaking a venture.

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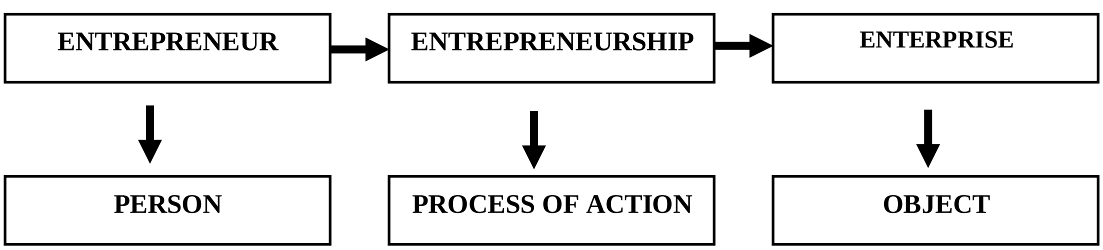
According to Richard Cantillion, an enterprise or entrepreneur is a person who pays a certain price for a product to resell it at an uncertain price thereby making decisions about obtaining and using the resources while consequently admitting the risk of enterprise.

J.B. Say asserts that an entrepreneur is an economic agent who unites all means of production, land of one, the labour of another and the capital of yet another and thus produces a product. By selling the product in the market he pays rent of land, wages to labour, interest on capital and what remains is his profit. He shifts economic resources out of an area of labour and into an area of higher productivity and greater yield.

According to Schumpeter, entrepreneurs are innovators who use a process of shattering the status quo of the existing products and services, to setup new products or new services.

David McCleland sees entrepreneur as a person with a high need for achievement. He is energetic and a moderate risk taker.

Fig: 1 GRAPHICAL REPRESENTATION OF THE CONCEPT OF ENTREPRENEURSHIP



An entrepreneur searches for change, responds to it and exploits opportunities. Innovation is a specific tool of an entrepreneur hence an effective entrepreneur converts a source into resources, Peter Drucker. According to Collins Dictionary, Enterprise is the ability to think of new and effective things to do, together with an eagerness to do them. Ability to get something started.

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2.1 MEASURING THE PERFORMANCE OF SMALL BUSINESS ENTERPRISES

There is increasing need for business enterprises to be strengthened and to improve their performance to remain financially relevant and avoid going moribund on a short-run. Advertising and diversification will enable them remain relevant and competitive in the business globe, among others. Measuring performance is a structured system or approach used to assess the effectiveness and efficiency of progress in implementing projects, programs, works and initiatives (Davis, 2007 and Chamaris, 2012). It is also used to assess the performance of various aspects of business, including marketing, sales, accounting, production, engineering, and others.

Companies or businesses measure performance to enhance essential decision making, show accountability, develop processes, and motivate employees.

2.2 THEORITCAL FRAMEWORK

This study was particularly based on two theories; the theory of profit and social change,and the theory by Max Webner. The former is critical in understanding profitability and factors that contributes to it, while the latter focuses on understanding the market forces of demand and supply that are allowed to play freely. Spirit of Capitalism promotes the entrepreneurs to engage in entrepreneurial pursuits and earn more and more profit. The urge to make money and profits drives the individuals to become entrepreneurs.

- ***Theory of Profit***

According to Cantwell (2002) the issue of what produces profit cannot be explained by only one theory. In other words, there are more than one theory for explaining factors that gave rise to profit, important ones among them were reviewed.

- ***The Innovation Theory of Profit***

This theory propounded by Schumpeter attributes profit to dynamic changes resulting from an innovation. This innovation may consist of the introduction of a new product, introduction of a new method of production, opening up of a new market, discovery of a new source of raw material and reorganization of an industry. Schumpeter (1934) theory of profit emphasized the role of entrepreneurship and the seeking out of opportunities for novel value generating activities which would expound and transform the circular flow of income.

Penrose (1998) modified this theory and focused on innovation as the source of profit which would be achieved through learning to develop new application of the current recourse base of the firm. This is opposed to profit due to the market position of the firm or the rent achieved through market price.

The Dynamic Theory, attributed to J.B. Clark assumed that profit is the result of dynamic change. However five dynamic changes are giving on in the society every time. They are increase in population, increase in capital, improved methods of production, multiplying consumer wants and changing forms of individual establishment. This theory states that profit is the result exclusively of these five dynamic changes.

However, Knight (1957) criticized this theory because it fails to make any difference, a change that is foreseen and one that is unforeseen in advance. Also there could be profit without any of the aforemention changes. Another important theory of profit as the residual income which the entrepreneur receives for the reason that he assumes risk. The entrepreneur exposes himself to risk and therefore receives a reward in the form of profit.

Marginal productivity theory of profit is also another important theory that sought to identify the major determinants of profit. Edgeworth, Chapman and Stonier have explained the determination of profit with the help of this theory. According to the theory, profit as the reward of an entrepreneur is determined by its’ marginal revenue productivity. The Higher the productivity the higher the profit and vice versa. However, this theory has been subjected to manycriticisms. Firstly, unlike other factors of production, marginal revenue productivity of entrepreneurship is a meaningless concept because there can be only one entrepreneur in a firm. Secondly because they differ in efficiency and cannot have one marginal revenue productivity curve. Thus this theory fails to determine profit accuracy (Cantwell, 2009)

In this study, attention will be paid to the innovation theory, dynamic theory, theory of social change, and marginal revenue productivity theory of profit. These theories of profit will be used to identify major determinants of profits in Enterprises.

2.4 SUMMARY OF LITERATURE REVIEW: THE MISSING GAP

There is a consensus among Entrepreneurship researchers that profit is a major determinant of small business sustainability. Studies on the distribution of profit are numerous but there is little or no studies on variables that give rise to the profit, hence small/medium scale enterprises go moribund within a short space of time (Garba, A.S., 2010). But whether such assertion is true in Nigerian context has not be determined. Again, major studies have not been done why small businesses have not been sustainable in Nigeria inspite huge resources that have been invested in the sector by both governmentand private sectors.

2.5 MODEL SPECIFICATION

To examine the determinants of profitability of small scale enterprises, the production function of Cobb-Douglas was employed. Oustapassidis and Notta (2005) described production function as the traditional tool for analyzing resources employed and returns they generate.

Following the production function approach, the level of returns or profit depends on the resources invested and their efficiency.

This is given as

Profit = (Capital, Business Volume, Managerial Efficiency)

The application of this method however has been extended to include other determinants of profit as propounded in different theories of profit.

Profit = f (capital, business volume, managerial efficiency, extent of innovation)

The above model could as well be adjusted to include other variables for more accuracy of result.

Profit = (Cap, pricing, finaid, yearop, bizvol, memstr, mgreff, innov)

Where Profit = total net profit generated by the business enterprise in a particular year (Dependent Variable)

Cap = Capital base of the business measured by total share capital and retained earnings

Price = Pricing policy of the business

Finaid = Whether the business has received external financial aid

Yearop = Number of years of operation

Bizvol = Volume of business measured by annual sales/turnover

Memstr = Managerial efficiency measured by percentage return on capital invested

The mathematical form of the model was given as

Profit = a+ b1 cap + b2 pricing + b3 finaid + b4 yearop + b5 bizvol + b6 memstr + b7 mgreff + b8 innov + e

Where a = constant

e = error term

3.0 Research Methodology

The equation was estimated using Ordinary Least Square (OLS) technique linear multiple regression analysis was used to establish the relationship between the dependent variable and independent variables. Also the characteristics of the sample were described in tables and simple percentages.

Hypotheses were tested using t-statistics. Decision rule was to accept the null hypothesis if the t-ratio calculated is less than the critical value otherwise reject.

Data Presentation and Analysis

Table 3.1 Characteristics of the Business Enterprises Studied

Type of Business	Option	Percentage
Agricultural	33	66%
Non-Agricultural	17	34%
Area of Operation		
Rural	29	58%
Urban	21	42%
Year of Operation		
Less than 5 years	5	10%
Between 6 and 10 years	18	36%
Above 10 years	27	54%
Membership Strength		
Less than 30	10	20%
Between 30 and 50	22	44%
Above 50	18	36%

Source: Chambers of Commerce and Industry, Asaba 2024

From the data presentation in Table 2.0 above, 66% of the business engaged in agricultural related activities while 34% are in other sector of the economy such as production, small scale trading etc.

Furthermore, the table revealed that while 42% of the businesses operate in urban centres or cities, 58% operate in rural area 36% of small businesses have existed for almost ten years while higher percentage of business have operated above ten years. Again, majority of the businesses have between 30 and 60 members. It would be inferred generally from the table that majority of the businesses were into agriculture and they operate in rural areas. They have existed for slightly above 10 years and their membership strength was greater than 30. Most of businesses go moribund before 15 years and so on.

Table 2.2 Financial Characteristics of the Businesses

Capital Size	Response	Percentage
Below N5 Million	18	36%
Between 5 – 10 Million	17	24%
Above N10 Million	15	30%
Pricing Policy of the Business	NIL	NIL

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Below the Market Price	34	68%
Equal or above the Market Price	16	32%
Annual Business Volume	NIL	NIL
Below N5 Million	9	18%
Between 5 – 10 Million	11	22%
Above N10 Million	30	60%
Net Profit	NIL	NIL
Less than N1 Million	18	36%
Between N1 Million and N2 Million	12	24%
Above N2 Million	20	40%
External Financial Aid	NIL	NIL
Received Financial Assistance	19	38%
Did not receive Financial Assistance	31	62%

Source: Chambers of Commerce and Industry, Asaba 2024

Analysis of Financial characteristics of the businesses revealed that the capital base of majority of the businesses were not above N10 Million notwithstanding that many of them have operated for more than ten years. However, their annual business turnover was over N10 Million. This implies that these businesses were undercaptilized. They tend to depend more on credit facilities such as Microfinance Banks, Bank of Industries (BOI) to fund their operations. Low capital base of these businesses more often than not lead to failures. Moreover, only 38% received financial aid from external sources as against 62% which did not receive any help.

Table 2.3 Regression Estimation Result

Variable	Coefficient	t-Statistics	Significance Level
Constant	1.303		
Cap	0.840	3.38	*0.016
Yearop	0.083	-0.530	0.599
Pricing	-0.046	0.355	*0.041
Finaid	0.061	5.477	0.636
Mgreff	0.560	1.061	*0.039
Bizvol	0.314	1.038	*0.0487
Membst	-0.11	2.403	0.361
Innov	-0.107	-0.882	0.3838

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R = 840.84

R^2 = 0.76

Adjusted R^2 = 0.771

Note * means significant at 5% level

3.1 RESULTS AND DISCUSSION

A close inspection of the regression result indicates that only four variables were statistically significant. These variables were capital base, pricing policy, managerial efficiency and business volume. This means that these are major determinants of the value of business gains or profit. Capital base was positive and significant which suggests that increase in capital base will lead to increase in profit. It has a coefficient of 0.84 which implies that if capital base increase by N1,000, profit will increase by N83. This was in tandem with managerial efficiency. One percent increase in managerial efficiency will cause profit to increase by N560 business volume also had positive relationship with amount of profit. If it increases by N1,000, profit will also increase by N314.

However, pricing policy innovation membership strength had negative signs which suggested that they had inverse relationship with the amount of profit. Selling below the market price will lead to a decrease of N146 for any N1,000 transaction. Increase in membership will also lead to a decrease in profit as shown in the regression result. Addition of one new member decreases the amount of profit by N110. Surprisingly, the result revealed that increase in innovation will result to a decrease in profit by N107 because according to the theory innovation, the activities of entrepreneurs represent a situation of disequilibrium as their activities break the routine circular flow, J.A. Eze and Onodugo V.A., 2023.

The number of year entrepreneurs have operated has a positive relationship with the amount of profit generated, but sometimes it varies because even businesses that have operated above 10 years sometimes fail. However, it was not statistically significant.

Also, financial assistance to business organizations have positive relationship with the profit but still not significant at 5% significance level. The coefficient of determination relating to the goodness of fit measured by R^2 indicates that the 76% of the changes in profit were explained by the independent variables

HYPOTHESIS TESTING

Hypothesis 1: There is no significant relationship between the capital base of business venture and amount of profit generated.

H_0: b_1 Cap = 0

Decision rule: Accept H_0 if the calculated t-statistics is less than the critical value of t-statistics

Critical value = 1.645

t-statistics = 3.38

Since 3.38 < 1.645, the null hypothesis was rejected.

Therefore, we conclude that there is a significant relationship between the capital base of the business and profit generated

Hypothesis 2: There is significance relationship between introduction of innovation in business enterprise and increase in capital.

H_0 : b_8 innov > 0

Critical value = 1.645

t-statistics = 3.931

Since 3.931 > 1.645, the null hypothesis was rejected.

Therefore, we conclude that there is no significant relationship between introduction of innovation and amount of profit declared.

Hypothesis 3: Increase in membership causes increase in amount of surplus

H_0 : $b_6$membstr> 0

Critical value = 1.645

t-statistics = 2.403

Since 2.403> 1.645, the null hypothesis was rejected.

Therefore, we conclude that increase in members of business organization in the rural/semi-urban areas does not increase the surplus profit of such organization.

Hypothesis 4: External financial aid increase the amount of surplus generated.

H_0 : $b_3$finaid> 0

Critical value = 1.645

t-statistics = 5.477

Since 5.477> 1.645, the null hypothesis was rejected.

Therefore, we conclude that external financial aid does not increase the amount of surplus generated.

4.0 CONCLUSION AND RECOMMENDATIONS

This study focused on determining major financial variables that affect profit and endanger growth in small business enterprises using 2020 data from selected business enterprises in Ndokwa nation that comprises 3 Local Government Areas of Delta North Senatorial District.

The principal findings were that:

- Capital base of a business venture, pricing policy adopted by the entrepreneurship, managerial efficiency and effectiveness, and volume of business transaction were major determinants of profitability in business organization.
- Positive and strong relationship exists between capital base of business organizations and profit generation. This means that increase in capital base will lead to increase in profit.
- Pricing policy of business organization has considerable effect on the amount of profit generated. Business enterprises that sell below the current market price would have lower profit compared to the organizations that sell at current market price.

- Increase in size of membership does not lead to increase in the value of profit. This suggest that membership strength of any business organization does not determine the value of profit.
- External financial assistance to business organization does not have significance effect on the value of profit. This implies that external aid does not increase the profit of business organization. The nexus between external aid and small business profit is weak.
- Innovation theory of profit was not applicable because it destabilizes the equilibrium state of the business especially in a short run.

4.1 CONCLUSION

The importance of profit in business enterprises and its growth need not overemphasized. Business organizations need profit in order to achieve set goals and remain resolute and competitive devoid of failure. Although many financial variables have been identified as determinants of profit generation and business growth, this study had succeeded in pinpointing four major variables that were so significant in growing small business organizations in order not to go moribund. Business and financial managers shall find this study relevant to give their businesses a new positive direction for sustainability.

4.2 RECOMMENDATIONS

The findings from the study raised some policy issues and recommendation, these includes;

- Business organizations should ensure that they have strong capital base as this was the major determinant of profitability and sustainability of especially small business organizations in particular and other class of businesses in general. This can be achieved by increasing share capital and building the reserve fund. It leads to fund expansion and increase of business volume.

- Business managers (entrepreneurs) should be cautious on the pricing policy. Selling below market price to attract customers is not desirable for business organizations that intend to make profit. Members should not complain of poor patronage rebate if they did not want to the pay the market price.
- Particularly, small businesses should learn to lay emphasis on managerial efficiency and effectiveness as these are critical in determining the amount of profit to be generated by the business organizations. Efforts should be made to minimize waste and underutilization of assets.
- It is high time managers(entrepreneurs) started looking inward and thinking aloud by having business seminars in line with global best practices to make our local and small business organization sustainable. Though in entrepreneurial world, failure is a stepping stone to business growth. The maxim of self-help through mutual help should be enforced, while external assistance should be discouraged as the study has shown.

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